COUNCIL on FOREIGN RELATIONS

RENEWING AMERICA

POLICY INNOVATION MEMORANDUM NO. 13

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From: David M. Marchick

Re: Fostering Greater Chinese Investment in the United States

China recently became the world's second-largest economy and has emerged as the world's largest exporter and second-largest destination for foreign direct investment (FDI). In the past two years, China alone has contributed 16 percent of global GDP growth. Yet despite its rapid economic rise, China lags in one important area: outbound foreign direct investment (OFDI). China's OFDI has grown rapidly, but it remains relatively low—lower even than that of Ireland and Singapore. Historically, the United States has garnered approximately 15 percent of total global OFDI flows, yet currently it receives only 2 percent of China's OFDI.

President Barack Obama's meetings in February 2012 with Xi Jinping, China's vice president and soon-to-be leader, provide an opportunity to address this issue and establish an economic framework to help rebalance the global economy. Creating a positive economic framework will help mitigate the inevitable stresses on the U.S.-China relationship as leaders in both political parties sharpen their anti-China rhetoric during the 2012 U.S. election. China's outward investment has substantial room to grow, and the United States has the potential to capture a larger share of it—an outcome that would benefit the U.S. and Chinese economies and strengthen the bilateral economic relationship. China could be transformed into a large overseas investor, not just an exporter. At the core of that framework should be an unequivocal policy of fostering additional Chinese investment into the United States, so long as particular investments do not compromise U.S. national security interests.

THE PROBLEM

A number of hurdles to investment in the United States are internal to China. State-owned enterprises (SOEs) accounted for approximately 70 percent of China's global OFDI stock in 2009. Most SOEs are internally focused, risk-averse, and lack professional management capabilities to run complex international operations. SOEs also require government approval of specific overseas investments, a process in conflict with the frequent fast pace of bidding processes for companies. Outside of SOEs, many successful Chinese companies remain small. Their expansion plans

are typically limited to neighboring cities or provinces, not distant continents. They have neither the wherewithal nor the desire to invest heavily in the United States.

Equally significant are the perceived, and sometimes real, political backlash and regulatory risks associated with their investments in the United States. The struggle to operate within the legal, regulatory, and political systems is a mutual concern for China and the United States.

Many Chinese executives and government officials remain frustrated by the political controversy or regulatory resistance engendered by a few investments. Conversations with Chinese executives frequently turn to the failed attempt by the Chinese National Offshore Oil Corporation (CNOOC) to acquire Unocal Oil Company or to Huawei's problems with the Committee on Foreign Investment in the United States (CFIUS), the U.S. government's interagency group that reviews investment on security grounds. Consequently, many Chinese executives believe the United States is unwelcoming of Chinese investment, even though the vast majority of Chinese investments in the United States have either been approved or have not required any approval.

THE RATIONALE FOR CHINESE INVESTMENT IN THE UNITED STATES

Openness to foreign investment generally benefits the United States, generating high-paying jobs, facilitating investment in research and development (R&D), and strengthening the country's manufacturing base. President Obama recently stepped up efforts to attract foreign investment, expanding the Commerce Department's investment promotion arm and proposing other measures to encourage "insourcing."

Given the slow pace of the economic recovery, the United States would benefit hugely from additional FDI. Critics argue that Chinese investment could compromise U.S. security interests and lead to job offshoring. While Chinese acquisition of certain U.S. companies in the defense or technology sectors would create national security concerns, the preponderance of potential Chinese investments in the United States would raise no such issues.

Chinese investment would promote new economic activity and expose Chinese companies to Western standards of corporate governance, reporting, and accounting. More FDI would boost U.S. exports to China, as Chinese companies look to their U.S. operations to export back home. Moreover, the jobs created by additional Chinese investment in the United States would help generate greater American support for Chinese investment.

RECOMMENDATIONS FOR U.S. OFFICIALS AND COMPANIES

1. ***Clarify and amplify that it is U.S. policy to attract Chinese investment.*** President Obama has made strong statements about overall U.S. policy toward foreign investment. But to this point, no president, Republican or Democrat, has stated U.S. policy toward Chinese investment as clearly as Vice President Joseph Biden did in October 2011: "President Obama and I, we welcome, encourage and see nothing but positive benefit from direct investment in the United States from Chinese businesses and Chinese entities. It means jobs." President Obama should seize the opportunity with Vice President Xi to state clearly that the United States welcomes Chinese investment and that additional investment is in both countries' economic interest.
2. ***Bust myths and perceived biases.*** The vast majority of Chinese investments in the United States do not require any regulatory approval, and a number of important recent deals with Chinese companies that do require it have been successfully approved by CFIUS in the initial thirty-day review period. For example, CNOOC, the same company that encountered opposition in its bid for Unocal in 2005, recently acquired minority interests in both the Eagle Ford Shale (in Texas) and Niobrara Shale (in Wyoming and Colorado) without any

controversy. U.S. officials should continue to strictly scrutinize those few transactions that potentially harm U.S. national security. But most Chinese investments have not and should not raise real concerns. Senior U.S. officials should highlight the many successful investments Chinese companies have made during the Xi visit, countering the natural tendency to focus on the most problematic investments.

3. *Quantify CFIUS's results.* The recent CFIUS annual report said that sixteen transactions involving Chinese firms were reviewed by CFIUS between 2008 and 2010, but it did not say how many of these were approved. By showing the number of transactions that were approved, which presumably vastly outnumber problematic transactions, Chinese companies would have more confidence to invest.

4. *Remove impediments and irritants to FDI.* Policymakers can remove impediments to Chinese investment through improvements in visa and tax policies and procedures. Chinese executives who pose neither a security threat nor a risk of staying in the country illegally still face delays and hassles obtaining visas. Tax policies, such as the Foreign Investment in Real Property Act (FIRPTA), which was adopted in 1980 to curtail Japanese investment in U.S. farmland, now impede foreign investment in the U.S. real estate sector at a time when such investment is needed. Other U.S. laws intended to reduce tax avoidance by citizens and residents have created burdensome reporting requirements that deter foreign investment in the United States. The likelihood of a successful Bilateral Investment Treaty (BIT) agreement in the foreseeable future remains small because of divisions in both governments and because China would find it hard to commit to binding open investment principles. Nevertheless, China and the United States should continue to advance BIT negotiations.

5. *Encourage private sector support for Chinese investments.* U.S. businesses operating in China can help their Chinese partners navigate complex regulations and allay fears of political backlash. For instance, IBM shepherded Lenovo through the regulatory and political process associated with the sale of its personal computer division in 2005. Other U.S. companies should do the same.

RECOMMENDATIONS FOR CHINESE OFFICIALS AND COMPANIES

1. *Further open China to U.S. investment.* China, which continues to maintain strict equity caps and sectoral restrictions on inward FDI, should take dramatic steps to eliminate investment barriers. Such actions would benefit the Chinese economy and U.S. investors, and would also increase U.S. receptiveness toward Chinese investment. At the same time, the United States should resist temptation to pursue investment policy based on reciprocity, since inward investment on its own creates economic benefits for the United States.

2. *Know the market.* Chinese companies also need to be prepared to become more "localized" in the United States. Japan's experience serves as an instructive example. Twenty-five years ago, Japanese investments were erroneously perceived as a threat to the United States. Today, Japanese investment is perceived positively as integral to the U.S. economy. Japanese companies invested in parts of the country that needed jobs, fostered and strengthened relations with local communities, worked with local officials, and partnered with U.S. companies, including through the establishment of joint ventures. Chinese companies can do the same.

CONCLUSION

Greater investment by China in the United States is not only a natural evolution in China's economic development; it also yields significant benefits to the economies and welfare of citizens of both countries. More than $1 trillion of FDI is projected to flow from China into the global economy by 2020. President Obama, by articulating the right policies and setting the right tone during the Xi visit, could help ensure that the United States receives a significant share of this investment—for both countries' benefit.

David M. Marchick is a managing director at the Carlyle Group, where he is global head of external affairs. He is the author of *U.S. National Security and Foreign Direct Investment.* Daniel R. Bowles is an associate at the Carlyle Group and assisted in the preparation of this article. A version of this article was originally presented at Columbia University's Conference on China's Economic and Trade Relations.

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